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C O N F I D E N T I A L CANBERRA 000330

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DEPARTMENT FOR EEB, EAP, EAP/ANP, EAP/CM AND EAP/EP

E.O. 12958: DECL: 04/01/2019
TAGS:
ECON, EFIN, PREL, CH, AS
SUBJECT: AUSTRALIA APPROVES CHINESE INVESTMENT IN IRON ORE MINER

REF: A. PERTH 19
¶B. CANBERRA 327 AND PREVIOUS

Classified By: Economic Counselor Edgard Kagan for reasons 1.4 (b/d).

Summary and Comment

¶1. (SBU) Treasurer Wayne Swan signed off March 31 on the recommendation of Australia's Foreign Investment Review Board to approve Chinese steelmaker Hunan Valin Iron and Steel Group's application to purchase up to 17.55% of iron-ore producer Fortescue Metals Group (FMG) (ref A). The A$645 million (USD 438 million) deal eases pressure on FMG, which is facing challenges managing A$3 billion in debt accrued in the comparatively rapid development of its assets. The deal is significant because it is widely being viewed as setting a precedent that is likely to guide how the FIRB will look at future Chinese investment in resource assets where China is a major customer. Following close on the heels of the March 27 decision to block Minmetals' purchase of OZ Minerals on the grounds that the deal included a mine close to a sensistive military facility (ref B), the decision signals that Australia is willing to permit PRC firms to take significant minority equity stakes in important resource companies provided that they are transparent and bring in investment without taking control. End Summary and Comment.

¶2. (SBU) The Treasurer's announcement said the approval is subject to "formal and strict undertakings" by Hunan Valin, particularly three conditions for nominating representatives to the FMG board of directors. Hunan Valin representatives would be required to:

-- comply with FMG's own code of conduct for its directors;

-- submit a formal notice of possible conflicts of interest on issues such as sales and setting prices;

-- commit to arrangements to ensure "information segregation" between FMG and Hunan Valin.

¶3. (C/NF) Rio Tinto Government Relations Manager Mark O'Neill (a keen observer of the FIRB and its treatment of Chinese investment because of Rio's pending deal with PRC-owned aluminum miner Chinalco) told us a few hours before the announcement that he expected the Government to approve the FMG deal. He said that the Australian Government is eager to signal that it is willing to accept Chinese investment under some circumstances and that the earlier denial of a request

by PRC-owned Minmetals to purchase OZ Minerals on security grounds (ref B) increased the likelihood that Hunan Valin would get a positive response. FMG is widely considered to be on thin ice due to the likely fall in iron ore prices and its large debt burden. O'Neill said that the Rudd Government would prefer to see FMG survive as an independent player in order to encourage the maximum amount of development of iron ore assets in Northwest Australia's Pilbarra region. In that regard, he noted that Treasurer Wayne Swan has supported giving FMG access to privately owned Rio Tinto and BHP infrastructure assets. Department of Foreign Affairs and Trade First Assistant Secretary for North Asia Graham Fletcher told us April 1 that there were few concerns about the Hunan Valin purchase of a stake in FMB because it was a Qthe Hunan Valin purchase of a stake in FMB because it was a very transparent and straightfoward deal that left FMG firmly in control of the management of the underlying assets. (Comment: A pointed reference to the Chinalco-Rio Tinto deal, where Chinalco is seeking to purchase bonds convertible into equity that would give it up to 18% of Rio Tinto as well as purchasing minority stakes in a number of Rio Tinto assets including the Hammersly Iron Ore complex in the Pilbarra. End Comment.)

¶4. (C/NF) Stephen Kennedy, Chief Macroeconomic Advisor to PM Kevin Rudd, told us April 1 that the FMG decision was complicated by the sheer number of controversial Chinese investments. He said that the Government had long seen the Hunan Valin investment as relatively straightforward. He said that while some argued that the Government should come up with a more comprehensive approach to cover all Chinese investment, the differences between companies and proposals make that difficult and had encouraged a quicker decision on the FMG deal based solely on its merits.

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